Oil Price Instability and Iraq in 2025

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Summary : In 2023, according to Iraq's revenue and expenditure report, 93% of the country's total revenue emanated from oil, amounting to 125.8 trillion dinars. In contrast, non-oil revenue stood at just 9.7 trillion dinars, or 7% of the total, a sharp deviation from the budget's initial projections for oil and non-oil revenues.

For the first time since December 2021, oil prices have dropped below $70 a barrel, sparking serious concerns for the final quarter of this year and Iraq's 2025 budget. The recent fluctuations in oil prices over the past few weeks have created significant challenges for oil-dependent countries like Iraq, which rely heavily on monthly oil sales and revenue redistribution.

There are multiple reasons for this instability and decline in oil prices. Chief among them is the economic slowdown in China. As a major consumer, accounting for 10% of global oil demand, China's deceleration is a key factor. However, there are other factors as well.

This price instability also reflects the growing impact of renewable energy and a shift away from conventional energy sources. While oil prices may continue to fluctuate in the short term, global consumption patterns are shifting, which will ultimately have a lasting impact on oil prices. In the future, energy consumers' forecasts are expected to be more accurate than those of energy producers.

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The imbalance between revenue and expenditure is stark, with annual spending rising while Iraq's income remains heavily reliant on oil. Over the past two years, wars, conflicts, and OPEC's interventions have helped Iraq avoid a deficit, even generating a surplus in annual revenues. However, a sharp increase in expenditures—by 11 trillion dinars in a single year—and a $10 per barrel drop in oil prices during that period worsened the disparity between actual revenues and expenditures in the 2024 budget compared to the Ministry of Finance's projections.

Iraq's 2024 budget shows total expenditures rising from 199 trillion dinars ($153 billion) in 2023 to 211 trillion dinars ($161 billion) in 2024. This increase is primarily driven by operational costs rather than investment in economic infrastructure. In 2023, nearly half a million new public sector employees were hired, with 370,000 transitioning from contract to permanent positions, despite significant funds being allocated for infrastructure renovations and strategic development projects in central and southern Iraq.

In rentier economies like Iraq, civil servant salaries serve as a means of redistributing the nation's wealth, promoting trade and social stability. Iraq exemplifies this model, despite significant disparities in wealth distribution. According to data from Iraq's Ministry of Finance, public sector salaries and pensions account for nearly 50% of total expenditures, having increased by 4% in just six months. For instance, in 2023, salary expenditures made up 45% of total spending, rising to 49% by mid-2024. During the first half of 2024 alone, total expenditures reached 58.2 trillion dinars, with salaries consuming 28.1 trillion dinars.

The recent sharp drop in oil prices poses a significant threat to Iraq's revenue. Between July and August, Iraq's oil revenues fell from $9 billion to $8.4 billion—a loss of $600 million—even though oil prices had not dropped as drastically as they have now. Energy agencies report that global oil demand continues to decline, largely due to China's economic slowdown. Since Iraq exports one-third of its oil to China, any further reduction in global demand will severely impact its revenues. If oil prices remain at their current level, Iraq will face two major challenges: volatile prices hovering around $70 per barrel and restrictions on production and exports due to the OPEC Plus agreement. A $1 decrease in oil prices below the budgeted level would reduce Iraq's annual revenue by $1.2 billion. Additionally, Iraq's OPEC-imposed limit on production and exports is 200,000 barrels per day lower than what was projected in its three-year budget, despite compensating for excess production from earlier in the year.

In addition to China's economic slowdown and the 280,000-barrel drop in daily demand, other factors also explain the volatility in oil prices. These include a 30% shift in Chinese tanker demand from diesel to liquefied natural gas (LNG) in the second half of this year, rising U.S. oil inventories, some countries' failure to meet voluntary production cuts under the OPEC Plus agreement (including Iraq and Mexico), and a surge in Iranian oil exports by 1.5 million barrels per day; all of this together better explains the reasons behind the volatility and decline in oil prices and determines the direction of prices in the future. As a result, OPEC has revised its demand forecast for the second consecutive month, extending it into 2025.

If oil prices do not recover and remain below $70, Iraq will have to reassess its 2025 budget, particularly in terms of oil production and revenue projections. This would likely require reducing expenditures, contrary to the increases voted for in the 2024 budget. Ultimately, Iraq must decide whether to pursue economic restructuring and diversification—given that the state can no longer sustain its enormous payroll—or continue to delay project expenditures, as seen in the past. Although a prime ministerial advisor has already indicated that salary expenditures will remain a priority, the question of how to balance Iraq's finances in light of falling oil prices remains critical.